Editor's note: **80 I.D. 599**

WHELESS DRILLING COMPANY

IBLA 72-248 Decided September 5, 1973

Appeal from decision GS-47 ! O&G whereby the Director, Geological Survey, affirmed an Oil and Gas Supervisor's order setting out a different basis for computation of the Government's royalty from oil and gas lease BLM 039498 (La.), and demanding payment of additional royalty thereon.

Affirmed.

Oil and Gas Leases: Royalties

In determining the amount of royalty due to the United States from production of natural gas from an oil and gas lease pursuant to sec. 3, Act of August 8, 1946, 60 Stat. 951, it is proper for the Geological Survey to use a base value which includes both the purchase price paid for the natural gas as established by the Federal Power Commission plus any additional sum paid by the purchaser of the gas to unit operator as consideration for the purchase of gas from the unit of which the federal lease is a part.

APPEARANCES: N. H. Wheless, Jr., President, Wheless Drilling Company; Lawrence R. Hoese, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C.

OPINION BY MR. HENRIQUES

Wheless Drilling Company has appealed from decision GS-47-O&G of November 8, 1971, wherein the Director, Geological Survey, affirmed the basis of royalty computation prescribed for oil and gas lease BLM 039498 (La.), Simsboro Field, Lincoln Parish, Louisiana, established by order of the Oil and Gas Supervisor, Tulsa, Oklahoma, dated July 20, 1970, as amended by order of July 31, 1970. The supervisor required that payments of royalty to the Government be based on the gross proceeds accruing to the lessee, including both the sale price of the gas produced and the tax reimbursement made by the gas purchaser to the producer.

The issue presented is whether the amount reimbursed by the buyer to the seller of part of the severance tax paid by seller on production from a unit well is properly to be included as part of the gross value of the production in computation of the Government's royalty from a federal oil and gas lease committed to the communitization agreement under whose terms the well was drilled.

THE FACTS

Noncompetitive oil and gas lease BLM 039498 (La.) issued April 1, 1955, to J. B. Berland, for a term of five years and so long thereafter as oil or gas is produced in paying quantities. Section 3, Act of August 8, 1946, 60 Stat. 951. The lessee is obligated to pay to the lessor royalty at the rate of 12-1/2 percent of the value of the production removed or sold from the leased lands, computed in accordance with the oil and gas operating regulations. 30 CFR 221.47, 221.50. By mesne conveyances, record title to the lease has become vested as follows:

Owner	Percentage
Wheless Drilling Company	43.7500
Wheless Drilling Company, Trustee	12.5000
S. B. Hicks	8.7500
I. Lieber	2.1875
J. R. Querbes, Jr.	8.7500
George D. Nelson	2.1875
J. Pat Beaird	21.8750

The lease embraces the E 1/2 NW 1/4 sec. 9, T. 17 N., R. 4 W., La. Mer., Lincoln Parish, Louisiana, containing 79 acres.

By its Order 222.1, dated August 28, 1957, the Louisiana Department of Conservation, inter alia, designated all sec. 9, T. 17 N., R. 4 W., La. Mer., as a 640!acre drilling and spacing unit within the Simsboro Field, pursuant to the Department's earlier Order 222.

Communitization Agreement 14-08-001-5303, approved January 19, 1959, by the Acting Director, Geological Survey, covers the 79 acres of federal land in lease BLM 039498 (La.), and the remaining 553 acres of privately owned land in sec. 9, T. 17 N., R. 4 W., effective as of June 1, 1958. The federal land comprises one!eighth of the unit area. Under the Agreement, all rights to the dry gas and condensate producible from the Hosston "L" zone of the Travis Peak formation in the said sec. 9 are communitized.

Wheless Drilling Company, operator of the unit, completed the #1 T. L. James well on private land in the NW 1/4 SE 1/4 sec. 9, on July 3, 1958, as a gas producer with initial production of 5-1/2 million cubic feet of gas per day. All production from this well is allocable in accordance with Communitization Agreement 14-08-001-5303. Lease BLM 039498 (La.) became productive by virtue of being part of the unit.

Commencing August 14, 1958, gas produced from the #1 T. L. James well has been purchased by the Arkansas Louisiana Gas Company, a pipeline company operating in interstate commerce. Prices paid for the gas have been in accordance with field rates established by the Federal Power Commission [FPC], as follows:

$ 0.11921 per thousand cubic feet of gas [Mcf]
until October 1, 1961
$ 0.12370 per Mcf until September 30, 1964
$ 0.12820 per Mcf until September 30, 1967
$ 0.13270 per Mcf since October 1, 1967

The State of Louisiana levies a severance tax upon all natural resources severed or produced from land or water, including natural gas, within the State. 47:631 La. Rev. Stat. of 1950, as amended and supplemented. The present impost, applicable since December 1, 1958, is 2.3 cents per Mcf, unless the producing well is incapable of producing an average of 250,000 cubic feet of gas per day, in which case the severance tax rate is reduced to 1/3 cent per Mcf. 47:633 La. Rev. Stat. of 1950, as amended and supplemented. Payment of the tax is the responsibility of the owners of the resource at the time of severance, in proportion to the quantity of their respective interests. 47:632 La. Rev. Stat. of 1950, as amended and supplemented. The terms of lease BLM 039498 (La.), at sec. 2(k), provide that the lessee will pay all taxes lawfully assessed and levied under the laws of the State upon oil and gas produced from the leased lands. The Government's royalty interest, however, is not charged with its pro rata share of the severance tax, as all other royalty owners are charged.

Pursuant to Article 9 of the gas sales agreement between Wheless Drilling Company, seller, and Arkansas Louisiana Gas Company, buyer, to which agreement production from lease BLM 039498 (La.) was committed July 1, 1958, the seller shall pay all existing severance taxes [the Louisiana severance tax on natural gas at that time was $ .003 per Mcf], but in the event that there is a later increase in the severance tax, the buyer will reimburse the seller for 2/3 of such additional tax. The State of Louisiana, in fact, did increase its severance tax on natural gas to $ .023 per Mcf, effective December 1, 1958. Thereafter, Arkansas Louisiana Gas did reimburse Wheless for 2/3 of the increase of 2 cents per Mcf, or $ 0.013333 per Mcf, on natural gas purchased from the #1 T. L. James well. It appears that Arkansas Louisiana Gas owns .1864175 interest in the #1 T. L. James well, so that actual reimbursement of severance tax paid to Wheless is for only .797958 interest, with no reimbursement being paid for the Government's royalty interest of .015625.

In practice, the buyer, Arkansas Louisiana Gas, does all the actual accounting work for the seller, that is, it computes the value of gas taken [at FPC-approved prices], the amount of Louisiana severance tax, and the amount of reimbursement due under its gas sales agreement to repay part of the increased severance tax, and then makes payments as appropriate. As no severance tax is levied against the Government's royalty interest, no reimbursement is applied to it, so the royalty payment on the Government's share of royalty from inclusion of lease BLM 039498 (La.) in the #1 T. L. James well unit has been computed strictly on the basis of 1/64 of the total FPC!set price per Mcf, based on the Government land being 1/8 of the unit, and the Government royalty rate being 1/8 of production.

In June 1970, when the Oil and Gas Supervisor became aware that Arkansas Louisiana Gas had been buying gas from the #1 T. L. James well for the contract price (the FPC!approved unit price per Mcf) [currently $ 0.132700 per Mcf], plus the tax reimbursement of $ 0.013333 per Mcf as provided in sec. 9 of the gas purchase contract, for an average weighted price of $ 0.146033 per Mcf, he called upon Wheless by letter of July 20, 1970, for payment of additional royalty to the United States on the $ 0.013333 per Mcf received for the interest of lease BLM 039498 (La.) since December 1, 1958.

Arkansas Louisiana Gas replied that no severance tax had been deducted from the Government's royalty interest, so no tax reimbursement had been paid thereon, and that the Government's royalty had always been computed as 1/64 (.015625) of the value of the total production from the #1 T. L. James well, based on the FPC!established contract price.

The Supervisor then, on July 31, 1970, modified his demand to call for payment of additional royalty to the Government based on a tax reimbursement of $ 0.013125 ($ 0.013333 x .984375) per Mcf, in recognition of the fact that no tax reimbursement is paid for the .015625 tax-exempt interest of the Government.

The Director, Geological Survey, affirmed the Supervisor's demand, and this appeal followed.

The issue presented in this case is one of first impression for the Department. Wheless contends that since no severance tax is applicable to that portion of the production from the #1 T. L. James well attributable to the Federal royalty interest, the Government is not entitled to share in any proceeds which accrue to Wheless from the reimbursement of such taxes, which it has paid. Geological Survey maintains that, within the ambit of 30 CFR 221.47, "gross proceeds" for computation of the Federal royalty payment from its interest in the #1 T. L. James well includes the severance tax reimbursement.

Wheless contends that Federal lease BLM 039498 (La.), for computation of royalty attributable thereto, should be segregated from all other lands and interests included in Communitization Agreement 14-08-001-5303. Geological Survey argues that each tract of land within the communitized area shares ratably in the proceeds from the sale of gas and condensate produced from the communitized formation.

Wheless contends the demand by Geological Survey for payment of additional royalty based on the reimbursement of severance tax will result in unjust enrichment in the value of the federal gas through a net loss to the gas producer.

The oil and gas operating regulations, in discussing the "Value basis for computing royalties" at 30 CFR 221.47, use the expressions "estimated reasonable value" and "gross proceeds" as parameters in establishing the "value of production" for the purpose of computing royalty. The regulations direct that consideration be given to the highest price paid for production of like quality in the same field, to the price received by the lessee, and to the posted price, as well as to other relevant matters.

We recognize that authority to set field prices for natural gas sold in interstate commerce is vested in the Federal Power Commission, by the Natural Gas Act, 15 U.S.C. §§ 717 et seq. (1970). We recognize also that the field price established by FPC is not necessarily the "value of production" as that term is used in the oil and gas operating regulations, 30 CFR 221.47, especially when the additional factor of "gross proceeds" is considered.

Proceeds and fair market value may not be interchangeable. Proceeds of a sale, unless there is something in the context showing to the contrary, means total proceeds. United States v. Stanolind Crude Oil Purchasing Company, 113 F.2d 194, 198 (10th Cir. 1940).

The gas purchase contract involving the subject lease, entered into between Arkansas Louisiana Gas, the buyer, and Wheless, the seller, contains a provision in sec. 9 whereby the buyer will reimburse to the seller a specified percentage of any increase in the state severance tax above that in effect on the date of the agreement. The record shows that an increase in the state severance tax was imposed after the date of the contract, effective December 1, 1958, and that the buyer has reimbursed the seller the amounts specified in the sale agreement since that date.

It seems obvious to us that the buyer thus is paying to the seller an amount greater than the established field price for the natural gas it purchases from the #1 T. L. James well. It follows, therefore, that it is reasonable to compute the Federal royalty of the natural gas taken from this well on a unit value consisting of the field price established by FPC plus the amount of the severance tax reimbursed by the buyer. Within the context of 30 CFR 221.47, "gross proceeds" means the established field price for the natural gas plus any additional sums paid by the purchaser of the gas to the unit operator as consideration for the purchase of gas from the unit of which the federal lease is a part. In the present case, the unit value for purposes of computing the Federal royalty is $ 0.132700 plus 63/64 of $ 0.013333 [$ 0.013125] or a total of $ 0.145825 per Mcf. Wheless must comply with the demand by the Oil and Gas Supervisor for payment of additional royalty to the United States on the reimbursed severance tax by the buyer.

California Company v. Udall, 296 F.2d 384 (D.C. Cir. 1961) affirms the right of the Secretary of the Interior to establish "reasonable price" for royalty purposes. Kerr!McGee Oil Industries, Inc., 70 I.D. 464 (1963), held that the Secretary of the Interior in computing the basic royalty due to the United States under a lease may properly look to the actual consideration to be received by its lessee!seller under gas sales contracts with a buyer in order to determine the proper value basis for the royalty, and a determination by the Geological Survey that a reimbursement to the seller constitutes part of the contract sales price and should be included in the total value basis for the basic royalty computation is proper. We have applied these principles to the case at bar.

For the reasons set forth above we reject the contentions by Wheless that the federal royalties should be computed solely on the basis of the sale price of 1/8 of the gas produced from the #1 T. L. James well, the government!owned land being 1/8 of the communitized area. Absent any payments for reimbursement of severance tax or any other supplemental consideration, the FPC figure would probably be a proper base for computation of the royalty.

Likewise, we do not assent to the proposition that the computation of federal royalty on the gross proceeds, consisting of the gas purchase price plus the reimbursed severance tax, creates unjust enrichment of the Government's royalty interest. The Government is entitled to its royalty on the "reasonable value" of the gas as set by the Secretary, which by regulation may not be less than the highest gross price received for similar gas. We have determined that the base value for computation of the federal royalty in this case must include both the gas purchase price and the reimbursed severance tax.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Douglas E. Henriques
Member

We concur:

Martin Ritvo
Member

Edward W. Stuebing
Member